Risk Management

Credit Risk Management

Credit risk is defined as the risk of loss arising from any failure by a borrower or a counterparty to fulfill its financial obligations as and when they fall due.

Credit risk is the single largest risk faced by the Group. It is inherent in the activities of the Group such as loans and lending-related commitments, treasury and capital market operations, and investments. Business units have primary responsibilities for the day-to-day and active management of credit risks.

The Group's Credit Committee is delegated the authority by the Board of Directors to deal with all credit matters, including formulation of credit policies, approval of credit applications and the review of existing credit facilities.

The Credit and Country Risk Management Division within the Risk Management Sector provides independent oversight of credit risks and has the responsibility for the independent reporting and analysis of all elements of credit risk.

Credit risk exposures are managed through a robust framework of credit underwriting, structuring and monitoring processes. These processes, which include monthly reviews of all non-performing and special mention loans, ensure credit quality and the timely recognition of asset impairment. In addition, credit reviews and audits are performed regularly to proactively manage any delinquency, minimize undesirable concentrations, maximise recoveries, and ensure that credit policies and procedures are complied with. Past dues and credit limit excesses are tracked and analysed by business and product lines. Significant trends are reported to the Credit Committee.

Credit Approval Process

To maintain the independence and integrity of the credit approval process, the credit approval function is segregated from credit origination. Credit approval authority is delegated through a risk-based credit discretionary limit (CDL) structure to ensure that the CDLs are tiered according to a borrower's rating. The Group has a very stringent process for the delegation of CDLs based on the experience, seniority and track record of the officer. All officers with the authority to approve credits are guided by credit policies and guidelines, with distinctions made for institutional and individual borrowers. These credit policies and guidelines, which cover key parameters associated with credit structuring and approval, are periodically reviewed to ensure their continued relevance.

There is pervasive use of risk rating in the Group's credit decision process with the development and implementation of an internal credit rating system. This system incorporates both statistical models and expert-judgement scorecards, and is used as part of the credit approval process for non-retail exposures. The system ensures that ratings are assigned to borrowers in a consistent manner and systematically captures the rating history for future model back-testing and validation.

Generally, non-retail borrowers are assigned a Customer Risk Rating (CRR) and a Facility Risk Rating (FRR). CRR is a borrower's standalone credit rating and is derived after a comprehensive assessment of its financial strength, quality of management, business risks and the industry it operates in. The FRR of a borrower incorporates transaction-specific dimensions such as availability and type of collateral, seniority of the exposure and facility structure.

In contrast, consumer exposures are managed on a portfolio basis. The Group uses scorecards and stringent product programmes for credit underwriting purposes.

Credit Risk Concentration

Credit risk concentration occurs when the Group is exposed to borrowers who are engaged in similar activities or are located in the same geographical region, industry or have comparable economic characteristics such that their ability to meet their contractual obligations would be similarly affected by changes in economic, political or other conditions. To address credit risk concentration, the Group has in place policies and procedures to identify, measure, monitor and control these exposures. A rigorous process is established to regularly review and report asset concentrations and portfolio quality so that risks are adequately assessed, properly approved and monitored. These include concentration exposures by countries, obligors, industries and collaterals. Portfolio limits and triggers are in place to ensure that exposures remain within pre-determined boundaries.

Credit Stress Test

To assess the potential losses arising from the impact of plausible adverse events on the Group's credit portfolio, credit stress tests are periodically conducted. The extent of the plausible credit impairments is analysed to determine if potential losses are within the Group's risk tolerance.

Country Risk

Country risk arises where there is a risk that the Group is unable to receive payments from customers as a result of political or economic events in the country. Country risk is defined as the risk in cross-border lending resulting from events in the country. These events include political and social unrests, exchange control, moratoria, currency devaluation, nationalisation and expropriation of assets.

Country risk is managed within an established country risk management framework. The framework includes setting of cross-border limits for each country based on the country's risk rating, economic potential as measured by its GDP, as well as the Group's presence and business strategy in the country. Cross-border exposures are analysed and significant trends reported to the Credit Committee.

Credit Exposure from Foreign Exchange and Derivatives

To manage credit risk arising from derivative activities, master agreements, such as International Swaps and Derivatives Association (ISDA) agreements are established with counterparties. Such agreements allow the Group to cash-settle transactions in the event of counterparty default, resulting in a single net claim against or in favour of the counterparty.

In addition, the Group also establishes bilateral collateral support agreements with selected counterparties. Under such agreements, either party may be required to provide collateral, based on periodic valuations of selected portfolios, when exposure exceeds a pre-defined threshold.

Settlement Risk

Settlement risk arises in transactions which involve an exchange of payments in which the Group must honour its obligation to deliver but risks the non-delivery from its counterparty.

The Group's foreign exchange-related settlement risk has been significantly reduced, relative to the volume of our business, through our membership in the Continuous Linked Settlement (CLS) scheme. This scheme allows transactions to be settled irrevocably on a delivery-versus-payment (DVP) basis.

Customer loans

Loans and advances are made to customers in various industry segments and business lines. The top 20 obligor group borrowers and top 100 group borrowers made up 35.1% and 67.8% of total loans and advances respectively.

Obligor groups are defined in accordance with Notice to Banks, MAS 623, to comply with Section 29 (1)(a) of the Banking Act. Where the parent company is a borrower, exposures to the parent company and companies that it has 20% or more shareholding or power to control are aggregated into a single obligor group.

Total consumer loans, which consist of housing loans and loans to professionals & private individuals accounted for 56.6% of FEB Group's exposure as at 31 December 2006.

The composition of loans and advances and contingent liabilities (including non-performing loans) to customers as at 31 December were as follows:

By industry type (%)	Loans & advances		Contingent liabilities		Non-performing Loans	
	2006	2005	**2006**	2005	**2006**	2005
Manufacturing	**7.5**	7.5	**4.0**	3.8	**–**	–
Building and construction	**3.9**	4	**12.0**	12.6	**–**	–
Housing Loans	**33.5**	36.8	**–**	–	**26.3**	18.6
General Commerce	**24.9**	24.8	**35.6**	37.9	**6.2**	50.8
Transport, storage and communication	**1.2**	1.2	**12.5**	10.3	**–**	–
Non-bank financial institutions	**4.1**	3.8	**26.6**	24.2	**7.0**	22.6
Professionals and private individuals	**23.1**	20.5	**6.0**	7.7	**59.6**	8.0
Others	**1.8**	1.4	**3.3**	3.5	**0.9**	–
Total (%)	**100.0**	100	**100.0**	100.0	**100.0**	100.0
Total gross loans (S$ million)	**225.5**	270.4	**15.2**	15.6	**6.0**	7.8

Classification and impairment charges on loans

The Bank classifies its loan portfolios according to the borrower's ability to repay the loan from its normal source of income. All loans and advances to customers are classified into the categories of 'Pass', 'Special Mention' or 'Non-Performing'. Non-Performing Loans are further classified as 'Substandard', 'Doubtful' or 'Loss' in accordance with MAS Notice 612 (March 2005).

Write-off and charge-off policy

Classified accounts are closely monitored to ensure continued efforts are made to improve the Group's position and reduce its exposure. Where appropriate, such loans are transferred to in-house recovery specialists to maximise recovery prospects. A classified account is written off when there is no realisable tangible collateral securing the account, and all feasible avenues of recovery have been exhausted.

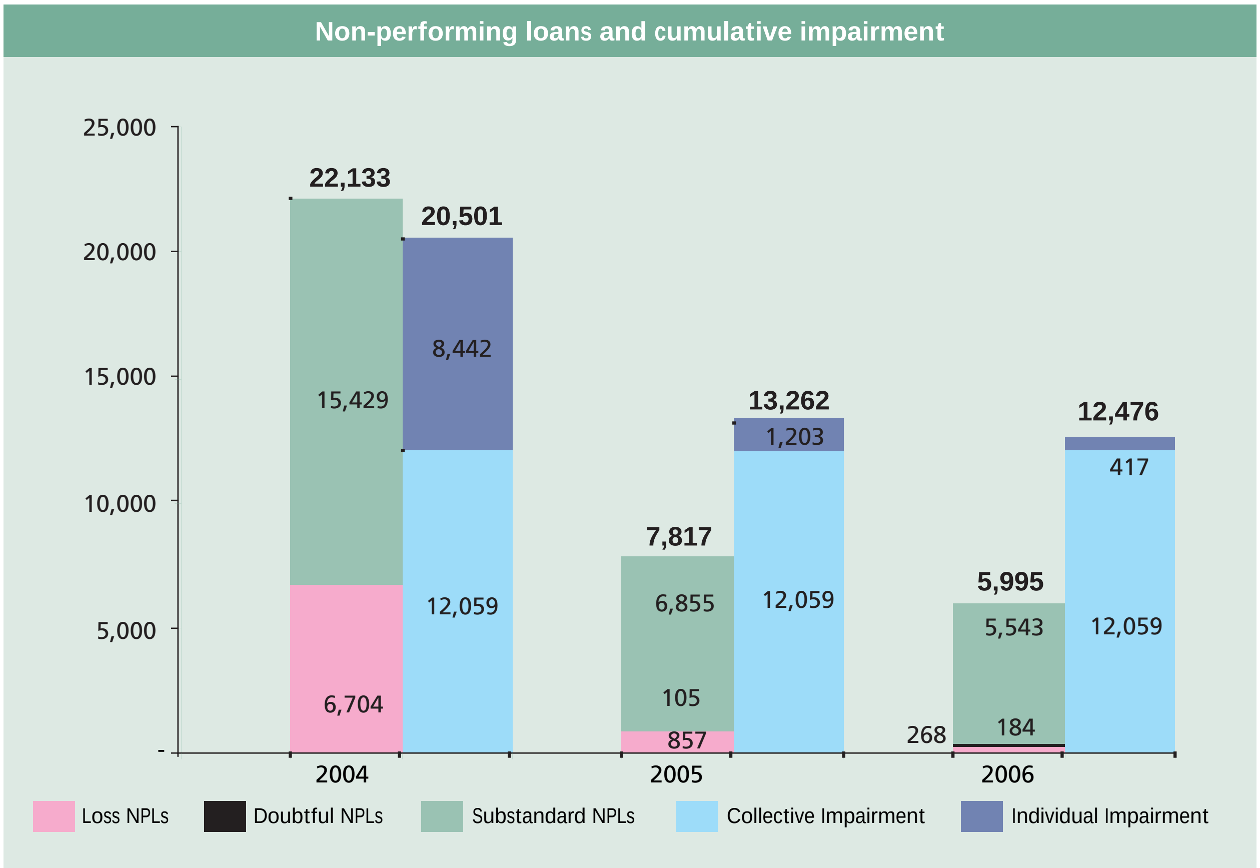
Risk Management

Non-performing loans (NPLs) and cumulative impairment of the Bank

The Bank's non-performing loans (NPLs) decreased by $1.8 million or 23.3% to $6.0 million as at 31 December 2006, compared to $7.8 million as at 31 December 2005. Correspondingly, NPLs as a percentage of gross customer loans improved to 2.7% as at 31 December 2006, from 2.9% as at 31 December 2005

Individual impairment declined by $0.8 million or 65.3% to $0.4 million as at 31 December 2006, compared to $1.2 million as at 31 December 2005. Collective impairment remained unchanged at $12.1 million or 96.7% of the total cumulative impairment as at 31 December 2006. The cumulative impairment provided 208.1% cover against the Bank's NPLs.

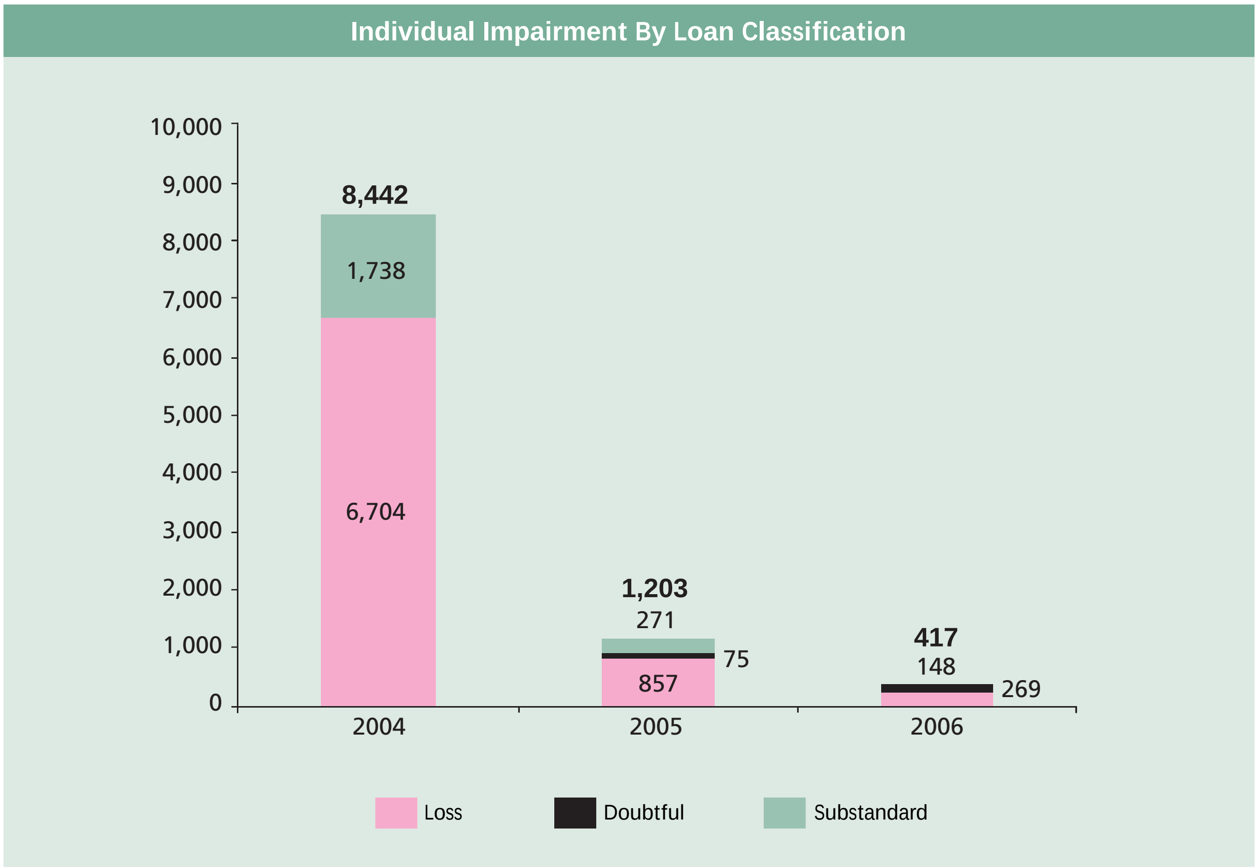
NPLs by loan classification and cumulative impairment as at 31 December were as follows:



Ratios (%)	2006	2005	2004
NPLs /Gross customer loans	**2.7**	2.9	7.1
NPLs/Total assets	**0.7**	0.9	2.7
Cumulative impairment/NPLs	**208.1**	169.7	92.6
Cumulative impairment/Unsecured NPLs	**2,760.2**	388.0	300.8
Cumulative impairment/Gross customer loans	**5.5**	4.9	6.6
Collective impairment/Gross customer loans (net of Individual impairment for loans)	**5.5**	4.5	4.0

Individual impairment by loan classification

As at 31 December 2006, about 64.5% of individual impairment made for expected loan losses is for ‘Loss’ accounts. The individual impairment for each classified loan grade is shown in the following chart:



Risk Management

Ageing of NPLs

Accounts that have payment records that are current or ≤ 90 days past due and/or in excess would be classified as 'Non-Performing' if the borrowers are deemed to be financially weak.

The full outstanding balance of an account is deemed non-current and aged when there are arrears in interest servicing or principal repayment. The ageing of NPLs at 31 December was as follows:

	2006		2005	
Ageing (Days)	**Amount ($'000)**	**% Of Total NPLs**	**Amount ($'000)**	**% Of Total NPLs**
Current	**3,440**	**57.4**	2,081	26.6
≤ 90	**1,629**	**27.2**	904	11.6
91 to 180	**590**	**9.8**	570	7.3
≥ 181	**336**	**5.6**	4,262	54.5
Total	**5,995**	**100.0**	7,817	100.0

Collateral Types

The majority of the classified loans are secured by properties. Properties are valued semi-annually. As at 31 December 2006, 92.5% of NPLs was secured by collateral, compared to 56.3% as at 31 December 2005.

The secured NPLs of the Bank by collateral type were as follows:

	2006	2005
	$'000	$'000
Property	4,224	4,398
Stocks & Shares	1,319	–
Total	5,543	4,398

Balance Sheet Risk Management

Balance sheet risk management is about managing interest rate and liquidity risks that arise out of the Group's core banking activities.

The Asset Liability Committee (ALCO), under delegated authority from the Board of Directors, approves the policies, strategies and limits in relation to the management of structural balance sheet risk exposures. These are monitored by the Balance Sheet Risk Management Division within the Risk Management Sector, and managed within a framework of approved policies and advisory limits. ALCO's decisions and its risk management reports are reviewed by the Executive Committee of the Board and the Board of Directors. At a tactical level, Global Treasury's Asset Liability Management unit is responsible for the effective management of the balance sheet risk in the banking book in accordance with the Group's approved balance sheet risk management policies.

Interest Rate Risk

In the course of its normal core banking activities, the Group strives to meet customers' demands and preferences for products with various interest rate structures and maturities. Sensitivity to interest rate movements arises from mismatches in repricing, underlying rates and other characteristics of assets and liabilities. As interest rates and yield curves change over time, the size and nature of these mismatches may result in a decline in earnings. The primary objective in managing balance sheet risk, therefore, is to manage the volatility in Net Interest Income (NII) and Economic Value of Equity (EVE).

Balance sheet interest rate risk exposure is quantified using a combination of dynamic simulation modeling techniques and static analysis tools, such as repricing schedules and sensitivity analysis. These schedules provide indications of the potential impact on interest income through the analysis of the sensitivity of assets and liabilities to changes in interest rates.

A positive interest rate sensitivity gap exists where more interest rate sensitive assets than interest rate sensitive liabilities reprice during a given time period. A positive gap in the shorter tenor benefits NII when interest rates are rising. Conversely, a negative interest rate sensitivity gap exists where more interest sensitive liabilities than interest sensitive assets reprice during a given time period. A negative gap on the shorter tenor benefits NII when interest rates are falling.

Interest rate sensitivity varies with different repricing periods and currency. Mismatches in the longer tenor will experience greater change in the price value of interest rate positions than similar position in the shorter tenor for prevailing rate change.

The table in Note 32(c) of Notes to the Financial Statements represents the Bank's interest rate risk sensitivity based on contractual repricing mismatches as at 31 December 2006. The Bank had an overall positive interest rate sensitivity gap of $265.1 million, which represents the net difference between interest rate sensitive assets and liabilities. The effect on NII depends on a number of factors, including variations in interest rates within the repricing periods, variations among currencies, and the extent of prepayments. The interest rate repricing profile, which includes lending, funding and liquidity activities, typically leads to negative interest rate sensitivity in the shorter term.

Complementing static analysis is the dynamic simulation process. In this process, the Group applies both the earnings and the EVE approaches to assess interest rate risk. The potential effects of interest rate changes on NII are estimated by simulating the possible future course of interest rates, expected changes in the Group's business activities over time, as well as the effect of embedded options. Embedded options may be in the form of loan prepayments and deposit premature upliftment. Changes in interest rates are simulated using different interest rate scenarios such as changes in the shape of the yield curve, including high and low rates, positive and negative tilt scenarios.

EVE is the present value of the Group's assets less the present value of the Group's liabilities. In EVE sensitivity simulations, the present values for the entire Group's cash flows are computed, with the focus on changes in EVE under different interest rate scenarios. This economic perspective measures interest rate risk across the full maturity profile of the balance sheet, including off-balance sheet items.

Stress testing is also performed regularly to determine the adequacy of the Group's capital in meeting the impact of extreme interest rate movements on its balance sheet. Such tests are also performed to provide early warnings of potential extreme losses, facilitating the proactive management of interest rate risks in an environment of rapid financial market changes. The results of such stress tests are presented to ALCO, the Executive Committee and the Board of Directors.

Liquidity Risk Management

Liquidity risk is defined as the risk to the bank's earnings or capital from its inability to meet its financial obligations as they fall due, without incurring significant costs or losses. Liquidity risk arises from the general funding of the Group's banking activities and in the management of its assets and liabilities, including off-balance sheet items. The Group maintains sufficient liquidity to fund its day-to-day operations, meet deposit withdrawals and loan disbursements, participation in new investments, and repayment of borrowings. Hence liquidity is managed in a manner to address known as well as unanticipated cash funding needs.

Liquidity risk is managed in accordance to a framework of policies, controls and limits approved by ALCO. These policies, controls and limits ensure that the Group monitors and manages liquidity risk in a manner that ensures sufficient sources of funds are available over a range of market conditions. These include minimizing excessive funding concentrations by diversifying sources and term of funding as well as maintaining a portfolio of high quality and marketable debt securities.

The distribution of deposits is managed actively to ensure a balance between cost effectiveness, continued accessibility to funds, and diversification of funding sources. Important factors in assuring liquidity are competitive pricing, proactive management of the Group's 'core deposits' and the maintenance of customers' confidence. 'Core deposits' are generally stable non-bank deposits, such as current accounts, savings accounts and fixed deposits. The Group monitors the stability of its 'core deposits' by analyzing their volatility over time. Customer confidence is founded on the Bank's good reputation, the strength of its earnings, and its financial strength and credit rating.

Aligning to the regulatory liquidity risk management framework, liquidity risk is measured and managed on a projected cash flow basis. The Group is monitored under "business as usual", "bank-specific crisis" and "general market crisis" scenarios. Cash flow mismatch limits are established to limit the Group's liquidity exposure. The Group has also employed liquidity early warning indicators and established trigger points to signal possible contingency situations. At the tactical level, Global Treasury's Asset Liability Management unit is responsible for effectively managing the overall liquidity cash flows in accordance with the Group's approved liquidity risk management policies and limits.

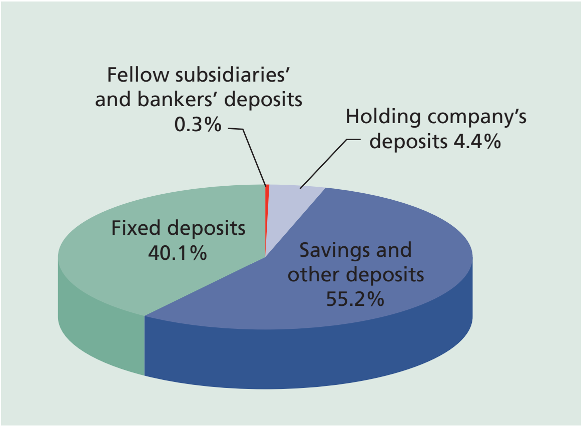
Liquidity contingency funding plans are in place to identify a liquidity crisis through early warning indicators; detailing crisis escalation process and the various strategies including funding and communication strategies to be taken to minimize the impact of a liquidity crunch.

The table in Note 32 (d) of Notes to the Financial Statements presents the maturity mismatch analysis of the Bank's near and long-term time bands relating to the cash inflows and outflows based on contractual classifications arising from the Bank's activities. The projected net cash inflow in the 'Up to 7 Days' time band of $73.5 million.

Sources of deposits

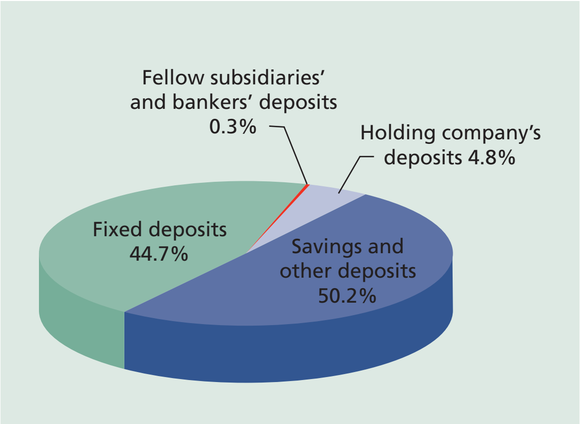
The Group has access to diverse funding sources. Liquidity is provided by a variety of both short-and long-term products. The diversity of funding sources enhances funding flexibility, reduces dependency on any one source of funds, and generally reduces the overall cost of funds. In making funding decisions, management considers market conditions, prevailing interest rates, liquidity needs, and the desired maturity profile of the Group's liabilities.

Non-bank customers' fixed deposits, savings and other deposits continued to form a significant part of the Bank's overall funding base in the year under review. As at 31 December 2006, these deposits amounted to $615.3 million and accounted for 95.3% of total Bank deposits. Fellow subsidiaries', bankers' and holding company's deposits on the other hand, amounted to only $30.4 million and formed the remaining 4.7% of total Bank deposits. In terms of deposits' mix, savings and other deposits comprised the majority of the funding base at 55.2% followed by fixed deposits at 40.1%.



Sources of deposits – 2006

	$'000	%
Customer deposits		
Fixed deposits	258,705	40.1
Savings and other deposits	356,618	55.2
Fellow subsidiaries' and bankers' deposits	1,988	0.3
Holding company's deposits	28,376	4.4
Total Deposits	645,687	100.0



Sources of deposits – 2005

	$'000	%
Customer deposits		
Fixed deposits	304,823	44.7
Savings and other deposits	342,866	50.2
Fellow subsidiaries' and bankers' deposits	1,833	0.3
Holding company's deposits	33,135	4.8
Total Deposits	682,657	100.0

Risk Management

Operational Risk Management

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Potential loss may be in the form of financial loss or other damages, for example, loss of reputation and public confidence that will impact the Group's credibility and ability to transact, maintain liquidity and develop new businesses.

Operational risk is managed through a framework of policies, processes and procedures by which operational risks inherent in the Group's business are identified, assessed, monitored, controlled, mitigated and reported to the UOB Group Management Committee, the Exco and the Board of Directors.

The Group's Management Committee, under its delegated authority from the Board of Directors, oversees the establishment of a sound operational risk management framework and monitors the operational risk profile of the Group.

In providing oversight of the management of the Group's operational risk, Operational Risk Management, a division of the Risk Management Sector, develops and maintains the Group's operational risk management framework, policies, processes and procedures. Operational Risk Management also supports and guides business units in the implementation of operational risk management programmes.

Operational risk management tools and processes include:

- Operational Risk Profiles (ORPs);
- Operational Risk Self Assessment (ORSA);
- Operational Risk Action Plan (ORAP);
- Key Operational Risk Indicators (KORIs);
- Analysis of operational risk events/loss data.

The building of ORPs involves identification and assessment of inherent risks as well as the controls to address the identified risks. ORSAs provide the analytical tool to assess the adequacy and effectiveness of such controls in mitigating these risks. Action plans to address any issues identified through the ORSAs are documented and monitored via the ORAP. The ORSA programme consists of a general control environment self-assessment and a risk and control self assessment covering core business processes.

KORIs are statistical data collected and monitored by business and support units on an on-going basis to facilitate the early detection of potential operational control weaknesses. Trend analysis is carried out to identify systemic issues that need to be addressed.

A database of operational risk events and losses has been established to facilitate the possible use of advanced approaches for quantification of operational risks. Additionally, the analysis of operational risk events will strengthen the operational risk management capability of the Group.

The Group's operational risk management framework also incorporates a new product/service programme process. This process aims to ensure that risks associated with the introduction of new products and services are identified, analysed and addressed prior to launch.

Online products and services require extra care and precautionary measures to protect customers' confidentiality and interests. Clear instructions are posted on the Group's website to advise and educate customers on the proper use and safekeeping of their access identification and passwords. To provide an additional layer of security, Two-Factor Authentication (2FA) was implemented in Singapore in December 2006. This improves the verification of online banking customer identity. With 2FA, online banking customers are required to provide a unique one-time password in addition to their username and password upon login.

With the increasing need to outsource internal operations to achieve cost and operational efficiency, the Group's Outsourcing Policy and framework ensures that outsourcing risks are adequately identified and managed prior to the introduction of new arrangements as well as in current arrangements.

Effective Business Continuity Management and Crisis Management strategies and plans have been developed, implemented and tested to mitigate the risk of major business and/or system disruptions. These ensure prompt recovery of critical business functions in the event of such disruptions.

The Group's operational risk management framework includes a Group Insurance Programme that mitigates the risk of high impact operational losses.

Legal risk is a part of operational risk. Legal risk arises from inadequate documentation, legal or regulatory incapacity, insufficient authority of customers and uncertainty in the enforcement of contracts. This is managed through consultation with the Group's legal counsel and external legal counsel to ensure that legal advice is appropriately taken.

As part of the Group's ongoing promotion of an effective risk management culture, an operational risk management training programme has been established.